Michael Spence writes: In July, the European Commission published its sixth report on economic, social, and territorial cohesion (a term that can be roughly translated as equality and inclusiveness). The report lays out a plan for substantial investment – €450 billion ($583 billion) from three European Union funds – from 2014 to 2020. Given today's difficult economic and fiscal conditions, where public-sector investment is likely to be crowded out in national budgets, this program represents a major commitment to growth-oriented public sector investment.

The EU's cohesion strategy is admirable and smart. Whereas such investment in the past was heavily tilted toward physical infrastructure – particularly transport – the agenda has shifted to a more balanced set of targets, including human capital, employment, the economy's knowledge and technology base, information technology, low-carbon growth, and governance.

That said, one can ask what the economic and social returns on these investments will be. True, sustaining high growth rates requires sustaining high levels of public investment, which increases the return to (and hence the levels of) private investment, in turn elevating output and employment. But public investment is only one component of successful growth strategies. It will do some good in all scenarios, but its impact will be much larger beyond the short term if other binding constraints are removed.

Three complementary issues seem crucial. One, mainly the province of the European Central Bank, involves price stability and the value of the euro. The second is fiscal, and the third is structural.

Inflation rates, now well below the ECB's 2% annual target, are in the deflationary danger zone. Because deflation drives up the real burden of sovereign debt and public non-debt liabilities such as pension systems, its emergence would undermine the already fragile state of many countries' public finances and kill growth.

In a post-crisis environment of aggressive and unconventional monetary policy in other advanced countries, the ECB's less aggressive policies (owing to its more restrictive mandate) have resulted in an exchange rate that has damaged competitiveness and the growth potential of many eurozone economies' tradable sectors. This is crucial, because most economies experienced pre-crisis growth patterns characterized by unsustainably high levels of domestic aggregate demand. So rebalancing requires shifting toward the tradable sector and external demand. A weakening euro will help.

The ECB understands this, and, without being explicit about it, is expanding its asset-purchase programs to elevate inflation and bring down the euro. ECB President Mario Draghi has been clear that restoring target inflation and weakening the currency is not a growth strategy. Difficult reforms are needed to put many national economies' fiscal affairs in order and to increase their structural flexibility. The ECB cannot do it alone.

On the fiscal side, sovereign-debt levels are too high and still rising. But the bigger challenge is the unfunded non-debt liabilities in pension funds and social-security

systems, which are estimated to be four times or more the size of sovereign debt. It is clearly necessary to implement credible plans to arrest the growth of these liabilities.

But these liabilities also have to be reduced, because they are already imposing a crushing fiscal burden, largely owing to rapid aging, with rising longevity a major contributor. The US has a similar problem, though it is more distant. A recent analysis for the US suggests that entitlements programs' liabilities will hit the public budgets in about ten years. By contrast, in Italy, for example, with its less favorable demographics, they have already hit.

Growth would reduce this burden, but growth in the short and medium term is highly problematic. Inflation would reduce the real value of both debt and other non-indexed non-debt liabilities. But even controlled inflation at higher levels has been ruled out; again, the current risk is deflation.

Governments could raise taxes to cover a larger fraction of the required expenditures. But that is not likely to help growth, and it imposes the burden on the workforce and the young who are trying to enter it, a valuable subset of whom are mobile and could simply leave. Likewise, issuing more debt to cover the portion of liabilities coming due would merely shift the composition of liabilities without reducing them.

The only other alternative is direct reduction. For sovereign debt, that means default, which will happen only in extreme circumstances; for non-debt liabilities, it means changing systemic parameters – for example, increasing the retirement age – which is contentious and exceptionally difficult to do politically.

The third missing ingredient is structural flexibility, which is needed for two reasons. First, most advanced economies have maintained the unbalanced growth patterns that led to the global crisis in 2008. Restoring growth requires structural changes.

In the US, though growth remains well below potential, data suggest that about half of the recovery in growth has resulted from a shift in capital and labor to the tradable side of the economy, with shale gas providing a big boost. That is either not occurring or happening at a glacial pace in southern European economies, where structural rigidities in labor and services markets need to be addressed. The exception is Spain, which initiated labor-market reforms in late 2012. Perhaps as these reforms' impact becomes more visible, reform momentum will increase in other countries.

Even without crisis-related imbalances, structural flexibility in all economies is necessary to adapt to the shifts caused by globalization and the labor-saving and skill-biased technological shifts associated with the rising value of digital capital. In the past 30 years, the global economy added 1.5 billion new connected workers in developing countries, with three billion new consumers in sight.

Digital technologies have eliminated millions of routine white- and blue-collar jobs, and we are rapidly entering the realm of cognitive-based employment. If investment in human

capital is to keep up with the changing composition of employment, structural flexibility is needed.

Europe has a real chance to conclude a bargain: member countries implement fiscal and structural reforms in exchange for short-run relaxation of fiscal constraints – not to increase liabilities, but to focus on growth-oriented investments to jump-start sustained recovery. Private investors would take note, accelerating the recovery process. The challenge now is to seize the opportunity.